TOOMEY/SHERMAN AMENDMENT TO TITLE IX OF HR 975
QUALIFIED FINANCIAL CONTRACTS

CURRENT LAW

The Federal Deposit Insurance Act (FDIA) relating to federally insured commercial banks, and the Federal Credit Union Act (FCUA) relating to federally insured credit unions have since 1989 had parallel provisions governing how these two federal banking agencies should handle "qualified financial contracts" (QFC's) in the event of a liquidation of a federally insured bank or credit union. Congress established the principle in 1989 that the FDIC and the NCUA should not "cherry-pick" which QFC's to honor when the agencies are acting in their capacity as the liquidating agent, receiver or conservator of a failed financial institution because doing so might cause financial distress in otherwise healthy financial institutions that are QFC counterparties with the insolvent institution.

The underlying laws establishing this principle and the definitions and terms that are applicable to the FDIA and the FCUA are the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and the Federal Deposit Corporation Improvement Act of 1991 (FDICIA).

TITLE IX OF HR 975

This title of the bill updates statutory definitions and procedures applicable to managing QFC's in the event of an insolvency, and keeps the statute in balance with developments that have taken place in this financial market over the last decade. However, Title IX was drafted only to amend bank statutes, and the Title fails to make the parallel changes to the Federal Credit Union Act.

TOOMEY AMENDMENT

The Toomey amendment redrafts the Title so the very same provisions in Title IX are applicable to both the bank and credit union federal regulators charged with managing these matters should in the event of a problem.

WHY THIS AMENDMENT SHOULD BE ADOPTED

- This should be viewed as just a technical and conforming amendment – making the same changes to all the related statutes that should be amended.
- Without this amendment, the Title creates a regulatory enforcement imbalance between bank and credit union regulators where none exists.
- Federal regulators for banks and credit unions need to work from the same set of rules since either regulator could be called upon to manage a problem involving counterparties (financial institutions) the other regulates and insures.

- This amendment has been reviewed by the staff of the financial agencies that compose the President's Working Group on Financial Markets and deemed it an appropriate and necessary compliment to the legislation.
- Like the FDIA, the QFC provisions in the FCUA are out of date and unclear in their application. It makes little sense to modify the FDIA provisions without also modifying the corresponding FCUA provisions.
- The modernization of the FCUA QFC provisions ensures predictability in the treatment of QFC's and ensures the stability of the QFC system in the event of a large credit union failure.
- The amendment expands and clarifies the FCUA definitions of QFC's and makes the credit union insolvency provisions of the FCUA more consistent in their treatment of similar contracts and with the FDIA treatment of those contracts.
- It revises and clarifies the definitions of the types of QFC's that benefit from netting in line with market innovations and practices and clarifies that parties to master netting agreements may agree to net obligations owed on different kinds of QFC's, such as swaps, commodity contracts, and repurchase agreements.
- It clarifies the notice and timing rights of the NCUA Board as liquidating agent to transfer or repudiate any QFC.
- It provides flexibility to the NCUA Board as liquidating agent in transferring QFC's held by failed insured credit unions to other market participants.

EXAMPLES

1. The NCUA is appointed as Liquidating Agent for Credit Union A, which has a large derivatives or QFC portfolio with Financial Institution B. Today, there is some ambiguity about whether the Liquidating Agent can transfer the portfolio to Financial Institution C or whether Financial Institution B has an absolute right to close-out the contracts. This may also benefit the market because it means that in the event of a portfolio transfer Financial Institution B can continue its normal contracts with the new counterparty, Financial Institution C, rather than have to replace them on the market and incur the required transaction costs. The amendment would clarify that "no provision of law" shall be construed as limiting the right of the Liquidating Agent to transfer the QFC's.
2. As the market has grown and changed, some contracts that NCUA believes to be QFC's are not listed in the current Federal Credit Union Act definitions. For example, Credit Union A enters into an interest rate swap with Financial Institution B. If Credit Union A becomes insolvent, that swap would not be a QFC and, therefore, Financial Institution B would not have the statutory right to close-out and net the contract so that it could protect itself. The legislation would resolve that problem in the Federal Credit Union Act and in the Bankruptcy Code.